DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Date: 2/8/08
Date: 11/8/07

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

Legend:
A = Name of Individual
B = Name of Individual
C = Name of Individual
D= Name of Individual
M = Name of State
N= Name of Entity
O = Name of Entity
P = Name of Publication
Q = Name of Newsletter
R = Name of Newsletter
S = Name of Entity
T = Name of Entity
U = Name of Entity
V = Name of Entity
W = Name of Entity
X = Name of Entity's Publication
Y = Title of Published Article

PACKAGE 1 = Name of Package
PACKAGE 2 = Name of Package
PACKAGE 3 = Name of Package

Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =

UIL Index:
501.32-00
501.32-01
501.33-00
501.03-33

a = Number
b = Number
c = Dollar Amount
d = Dollar Amount
e = Dollar Amount
f = Dollar Amount
g = Dollar Amount
h = Dollar Amount
i = Dollar Amount
j = Dollar Amount
k = Dollar Amount
l = Dollar Amount
m = Dollar Amount
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p = Dollar Amount
q = Dollar Amount
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s = Number
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u = Dollar Amount
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w = Dollar Amount
x = Dollar Amount
y = Dollar Amount
z = Dollar Amount
a1 = Dollar Amount
b1 = Dollar Amount
c1 = Dollar Amount
d1 = Number

Dear Applicant:

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

ISSUE:

Does your organization qualify for exemption under Internal Revenue Code section 501(c)(3) as a charitable or educational organization?

FACTS:

You were incorporated in the State of M on Date 1. Your Articles of Incorporation state that you are **"...organized exclusively for the purpose of serving as a resource center for compliance materials and services for the agribusiness industry."**

You submitted Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Code, as a charitable and educational organization. In the attachment to Part IV of Form 1023, you state that you are "...**organized to help agricultural businesses comply with the myriad of OSHA, EPA and DOT regulatory requirements. [Your] mission is the same mission as [your] predecessor, [N]....a for-profit corporation, except that [you] will be able to provide services to a substantially greater number of agricultural businesses through an alliance with national, regional and state trade associations."**

You are a successor to a for-profit organization, N. Your predecessor, N started in Date 6 with just a number of clients. It grew to b number of clients prior to the conversion to a non-profit entity. The owners of the for-profit entity were A, B, and C. A and B are husband and wife. The prior owners of N are now members of your Board of Directors. In Item 1a of the attachment to Schedule G, you provided that **"The three shareholders in [N] will become key employees in [your organization]." A will now serve as your President, B as your Secretary/Treasurer and C as your Vice President.** Since your Form 1023 submission, N has been dissolved.

Based on the information submitted on the Form 1023, your projected budget expenses showed total salaries as follows:

		2006	2007	2008
Officers/Directors	**$**	**c**	**c**	**c**
Other Salaries		**d**	**e**	**f**
Total Salaries	**$**	**g**	**h**	**i**

Compared to compensation expenses shown on the Form 1120S filed for N, your predecessor organization, salaries paid were as follows:

		2004	2005
Officer/Directors	**$**	**j**	**j**
Salaries and Wages		**k**	**l**
Total Salaries	**$**	**m**	**n**

While your employees are identical to the employees of the predecessor N, your compensation expense has increased significantly subsequent to the conversion to a non-profit entity; by over $300,000 annually and primarily to officers and directors. According to Form 1023, the officers and directors receiving compensation from you are:

A	**President**	**$o**
B	**Secretary/Treasurer**	**o**
C	**Vice President**	**p**
D	**Advisor**	**q**
		$ r

Thus, subsequent to your conversion, compensation expense has increased to account for the additional compensation paid to your current three key Board members who were also owners of the prior for-profit entity.

On Schedule G, you explained that the owners of N donated its assets including supplies, furniture, computers and printers valued at approximately $205,000 to you and no liabilities were transferred as a result of the non-profit conversion on Date 2. However, the owners of the predecessor, did not transfer to you ownership of the facility you use or copyrights to any intellectual properties developed or produced prior to the non-profit conversion. Moreover, the proprietary software, copyrighted materials and facility are to be updated and improved at your expense.

In fact, in addition to being a successor to a for-profit company, you are also related to O, which is a for-profit holding company for certain properties relating to the predecessor's operation. **Such properties include office building with s number of acres and training complex from which the organization will conduct its activities, a forklift and tractor/loader, video subjects and proprietary software and other intellectual property. You also stated that the three principals of N also own O.** It was indicated in the attachment to Part V of the Form 1023 that you have entered into a lease agreement with O. O has leased these same assets to N for the past six years for $t per year. **O would continue to own these assets and lease them to you for $t a year.**

In Part VIII of the Form 1023, you indicated:

> [O] owns certain intellectual properties which are protected by United States trademark and copyright laws. [You] will have full use of these materials through the annual lease. **All intellectual property developed by [N] prior to [date of conversion, Date 2] will remain the property of [O], including any revisions, updates, modifications or versions that may occur beyond that date.** All intellectual property developed after [date of conversion, Date 2] will be the property of [your organization].

The representative sample of your contracts with national and state associations and clients indicated that:

[Affiliates and clients] shall recognize and comply with all applicable trademarks, copyrights and rights of ownership of [your] materials, including but not limited to, proprietary computer software applications, website applications, audio visual materials, printed publications and any other form of media displaying [your] copyright or trademark.

Your lease agreement with O, provision seven stated:

> [You] may, at [your] sole expense, decorate and remodel the leased premises so long as such remodeling does not disturb the structural integrity of the building; and may not alter, decorate or improve the premises which might possibly affect the structural integrity of the building without [O's] prior written consent. **However, in any event, if any alterations, decorations or improvements to the premises are made, the same shall become a part of the leased premises unless the written consent expressly grants the right of removal or restoration.** Normal maintenance and repair and the reasonable installation of removal fixtures, equipment and similar items incident to the [your] use are not covered by this provision.

Based on your financial statements, all of your income is derived from fees for services rendered. Your proposed budgets showed gross receipts from fees for services rendered projected for calendar years ending December 31, 2006, 2007 and 2008 at $u, $v and $w respectively. You receive zero income from grants and donations. You indicated on your Form 1023 that you have no intentions of conducting any fundraising program.

You advertise to the public in order to expand your client base. For example, in one of your brochures, you indicated that:

> <u>Achieve a Better Bottom Line</u>
> With your state association and [our organization] on your side, you benefit from our comprehensive system of tracking and reporting data. Our clients reap the benefits from the reports we provide to monitor the status of drivers, training participation and respiratory qualification. Once seen solely as overhead **our clients now report savings associated with the reduction of violations, accidents, worker compensation claims and insurance premiums.**
>
> <u>Safety in Numbers</u>
> **Clients take comfort from the broad distribution of our services and materials.** An inspection or audit at any of our client's locations benefits every other client. **When a regulating agency asks for more than is required by law, our clients have allies in [our organization] and trade associations with the resources to help bring fairness to the enforcement action.**

In an article published in P, your President credited the Internet as:

> ... [our] "secret weapon" for efficiency. The sophisticated online system provides retailers a complete package for a fraction of what it would cost to complete forms in-house. **"We've been**

able to take virtually everything you need for compliance and reproduce it on the Internet. For less than [$x] a year, we can replace [$y] on-site staff person" he explains…

Your services also compete with those of other for-profit compliance consulting companies. In the same article, your president went on to comment:

We're different from other compliance services because we complete the reports, track the status and remind them action is necessary…

In your Date 3 response, item 18, you stated that "**[N] was considered a consulting firm which specialized in compliance for agricultural businesses."**

In your representative sample of your contract with state associations, you indicated:

This agreement may be terminated by either party with three hundred sixty five (365) days notice, or at an earlier date that is agreed upon by [you] and the affiliate…

This termination contract provision makes it difficult for state associations to cease its revenue sharing arrangement with you.

You do not operate a substantive ongoing public education program. Your compliance educational materials are provided on a retainer fee basis. You indicated on page 14 of your description of activities that even **the compliance information provided through your website is available only as part of your retainer services.** Furthermore, you stated that the manner in which you operate your business is identical to your predecessor for-profit entity with the exception that now you will service more clients by partnering with national and state association.

You have five levels of membership. Membership fees appear to be based on the services to be provided by you. Membership levels and descriptions as described in Article II of your Bylaws are as follows:

EDUCATIONAL – Shall be a domestic not-for-profit institution of higher learning, not otherwise eligible for membership that is interested in your work.
GOVERNMENT – A government member shall be a department, authority or agency of the United States government or of any State, interstate, regional or local government, interested in your work.
ASSOCIATION – An association member shall be any entity or individual of a state or national industry or trade association organization, not otherwise eligible for membership that is interested in your work.
REGULAR – A regular member shall be any member admitted to your organization after the date of your creation and not fitting any other category of membership.
CHARTER – A charter member shall be an entity or individual for whom services are contracted prior to the date you began operation.

You outlined the benefits offered to each membership level in Item 3 of your Date 3 response. The membership benefits and any applicable fees are as follows:

EDUCATIONAL AND GOVERNMENT MEMBERS – No fees are assessed. The benefit offered at these levels includes basic communications consisting of newsletter, Q, R and updates.
ASSOCATION MEMBERS – No fees are assessed. The benefits offered in this category include basic communications as described previously and Package 1 level of service.
REGULAR AND CHARTER MEMBERS – Fees are assessed based on level of service purchased. Besides receiving basic communications, these categories are entitled to receive Package 2 and Package 3 levels of service.

Service packages and fees offered by you are as follows:

Package 1 – includes a variety of resources free to the association to support membership efforts. It also provides the association access to certain services as required on an individual basis by its members.
Package 2 – available to state associations for use as an intermediate level of service. It is specifically designed as a tool for the state association member who prefers to administer their own compliance program but desires certain assistance. State association personnel receive training from the organization and the associations' personnel would be the primary point of contact to their members contracted for this level of service. No fees are charged to the state associations; however, the cost to the members is $z per manned facility per year.
Package 3 – it is comparable to the [N's] Retainer, which includes access to all services, products and materials offered by the organization. The package includes proven systems of monitoring and maintenance of driver qualification files, integrated return, tracking…and maximum cost-control efficiency from group purchasing and reimbursement rates for the materials necessary to compliance. This is a proven comprehensive package of services designed for the state association member who wants, needs or requires a more complete approach to compliance and the timely prompting and reminders offered.

No fees are assessed to the state association members. **Costs to your members for Package 3 are $a1 per manned facility with no on-site visit and $b1 per manned facility requiring an on-site visit per year. State association personnel would receive training from you and be expected to set up new members and conduct the annual compliance visit…the state associations' personnel would provide a secondary point of contact to its members contracted for this level of service.**

You retain between 63% - 79% of fees depending on the service package. The balance is distributed to the participating state association and $c1 per facility to S.

Operational net income is shared with national and state associations in order for these associations to promote your services among its membership. A number of these national and

state associations are trade or agricultural organizations described under section 501(c)(6) or section 501(c)(5) of the Code but none of them appear to be described under section 501(c)(3) of the Code.

According to your Bylaws, the criteria for Board membership are:

> **Members of the Board of Directors shall be knowledgeable and actively involved in environmental, health or safety activities. The makeup of the Board of Directors shall be such that all Members of the Board at any given time shall be representatives of Charter, Regular or Association members of [our organization] or representatives from the producers of fertilizers or agrichemicals or those entities manufacturing or supplying equipment and machinery to the fertilizer and agrichemical industry...**
>
> **If a member of the Board of Directors terminates his/her employment with a Charter, Regular or Association Members, or is transferred to a division of a Charter, Regular or Association Member company having no reference to the agribusiness industry, then said director shall be disqualified to serve as director and immediately tender his/her resignation from the Board of Directors; and a replacement director shall be elected by the Board of Directors.**

According to your Bylaws, the term of Board membership is:

> **Each director shall serve a three (3) year term and until the election and qualification of his/her successor. Officers may be re-elected to consecutive terms.**

Your Board consists of your prior predecessor owners, representatives of the national and state associations and client representatives.

The motivation to convert from a for-profit entity to a non-profit entity was explained as in Item 30 of your Date 3 response. In your letter, you stated:

> **A profit organization must be protective of its trade secrets. In [N's] situation, they are protective of their technologies and resources. The profit organization is financially harmed, if a sufficient number of non-payers gain free access to those technologies and resources. [N] limits the number of customers they handle so that their technologies can be controlled and protected. Many customers could mean publication of their technologies. There are not any patents or copyrights for these types of technologies. Everything they developed is from public records...**

You continued in the same response:

> **As for passing up opportunities, [the owners] did not believe in expanding beyond the farm centers that were paying them. As business owners and knowing their customers and potential customers, they believed the risk of expanding as a profit organization was**

not viable. They would not be able to protect the technologies they developed. As a nonprofit organization they would no longer have this concern.

On Page 1, attachment to Part IV of the Form 1023, you stated your predecessor "developed expertise in understanding government regulations affecting agriculture business and became their resource center by providing educational material, training programs, on-site inspections and, from their database, filing timely client reports with government agencies."

You further stated:

By switching from a for-profit to a nonprofit, [you have] the opportunity to benefit industry and continue development of technologies to meet the changing regulatory requirements. [You] will work in harmony with [T, U, V] and [d1 number of other] state associations (and expand as a resource center). More agricultural businesses can participate in the programs and come into compliance with regulations because costs will be lower.

You continued:

The associations will publicize the [your] educational materials, compliance aids, informational meetings, and services to an industry of approximately 6,500 agricultural businesses located throughout the agricultural producing regions of the United States. The associations will benefit because they will become a sponsor to the services [you provide] and receive revenue for their participation. The association's members will have a greater availability to resources and will receive their regulatory solutions at a lower cost. The U. S. Government benefits as more businesses are in compliance with regulations.

On Page 3 of the same attachment, you indicated:

[You] will retain the employees employed by [N] and continue the same regulatory services but to a greater number of agricultural businesses. The cost of the program services is based on time and material. The average annual expense of the program per client is less than $2,500. The cost structure for [you] will be similar to [N], except operational net income will be shared with the national and state associations.

You defend businesses in the agricultural industry from regulatory enforcement actions by governmental agencies. In the W Industry News Quarterly article, your President stated:

I can't count the number of times we've been called by retailers searching for a quick fix to get them out of a jam for a regulatory requirement that has been on the books for over 30 years. In practically all cases a little good faith effort would have prevented the retailer's dilemma. In every case the retailer already knew they should have been addressing the issue but for whatever

reasons had not gotten around to it...

The regulatory climate has changed over the past three years...We have witnessed a marked increase in the actions of the regulating agencies. Regulators are becoming more bold and even aggressive in pursuing their goals...

It is our belief that state associations such as [W] will be the first line of defense their members will look to for guidance and protection. **Our industry has an exemplary record in legislative activities but has suffered when it came to helping members with even the most basic regulatory issues or providing assistance in cases of uneven enforcement...**

In your Date 3 response, item 18, you provided that:

One of the first opportunities presented to [you] was to provide technical assistance and guidance in a case of uneven enforcement by a particular region of EPA. <u>One of the objectives of [your organization] is to fulfill the role of protecting the retail farm centers when over-reaching regulatory agencies abuse their power</u>. Most of the retail farm centers are considered small business and located in rural settings. They do not have vast resources to contest or even fight uneven enforcement. Most are scared of regulatory agencies such as the EPA and will not contest a violation even whey they know it is unjust.

In item 20 of the same response, you indicated:

Consolidation is taking its toll on our family farms and the effect trickles down to every agricultural business. The State and National associations that were organized many years ago to promote and protect the agricultural businesses have more recently felt the impact of consolidation. These associations are the first line of defense for retailers and other agricultural businesses, yet each time one retailer consolidates and buys another, the association's revenue from membership is reduced by half. **Consider the fact that compliance costs more than doubled from 2004 (4.8 billion) to 10 billion in 2005** (article attached) and the State and National associations are being asked to provide more of everything for less. It is an impossible scenario to sustain. The twelve State associations in so far have embraced the idea of having a quality resource to help them service their member's needs.

In the article from X, titled <u>Y</u>, it stated that **"While EPA investigated fewer environmental crimes, enforcement penalties jumped up from 2004 to 2005. EPA says that's because the Agency is successful prosecuting some of the largest environmental crimes in history."**

<u>LAW</u>:

Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, **provided that no part of its net earnings inures to the benefit of any private shareholder or individual**.

Section 1.501(a)-1(c) of the regulations defines a private shareholder or individual as "persons having a personal and private interest in the activities of the organization."

Section 1.501(c)(3)-1(b)(iii) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes, even though such organization is, by the terms of such articles, created for a purpose that is no broader than the purposes specified in section 501(c)(3).

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as **"operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3).** An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of this subsection, it is necessary for an organization to establish that it is not organized and operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled directly or indirectly by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes relief of the poor and distressed or of the underprivileged as well as the advancement of education.

Section 1.501(c)(3)-1(d)(3) of the regulations provides that the term "educational" refers to:

(a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or

(b) The instruction of the public on subjects useful to the individual and beneficial to the community.

In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. "Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, *inter alia,* whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations."

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation

formed to provide consulting services was not exempt under section 501(c)(3) because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, nor scientific, but rather commercial. Additionally, the court found that the organization's financing did not resemble that of the typical 501(c)(3) organization. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost." And finally, the corporation did not limit its clientele to organizations that were section 501(c)(3) exempt organizations.

In Easter House v. United States, 846 F. 2d 78 (Fed. Cir. 1988), aff'g 12 Cl. Ct. 476 (1987), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because it operated for a substantial commercial purpose rather than for the exempt purposes of providing educational and charitable services to unwed mothers and children. The services for unwed mothers and children were merely provided "incident" to the organization's adoption service business. The agency's operation was funded completely by the fixed fees charged adoptive parents. It relied entirely on those fees and sought no funds from federal, state or local sources, nor engaged in fund raising programs, nor did it solicit contributions. Moreover, the court found that "adoption services do not in and of themselves constitute an exempt purpose."

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. **The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.**

In Birmingham Business College, Inc. v. Commissioner, 276 F.2d 476 (5th Cir. 1960), the court denied tax exemption to an organization, in part because its net earnings were distributed to its shareholders for their personal benefit. The founder of the organization and his two sisters were the only shareholders; these three and two of their spouses were the organization's trustees. The court found that the organization was operated as a business ultimately producing substantial revenues for its operators.

In Church of Scientology of California v. C.I.R., 87-2 USTC P 9446, the appellate court agreed with the Tax Court that the royalty payments supported a finding of inurement. Royalty payments made by the church to its founder on sales of books, recordings and electronic devices, were excessive, and thus supported the determination that church's net income inured to benefit of individual. The founder used the church to generate copyrighted literature and market his products. In addition, church policy mandated that any book on subject be copyrighted in the name of founder, and a number of publications copyrighted by founder were actually written by church employees.

In Texas Trade School v. Commissioner, 30 T.C. 642, *aff'd*, 272 F.2d 168 (5th Cir. 1959), a school operated on property leased from the corporation's officers and made expensive improvements to property which became a part of the officers' property. The court ruled that the excessive and

unreasonable rent payments and improvements made by the organization resulted in inurement to its officers.

In International Postgraduate Medical foundation v. Commissioner, TCM 1989-36, the Tax Court concluded that when a for-profit organization benefits substantially from the manner in which the activities of a related nonprofit organization were carried on, the latter organization was not operated exclusively for exempt purposes within the meaning of section 501(c)(3), even if it furthers other exempt purposes.

In Revenue Ruling 61-170, 1961-1 C.B. 112, an association composed of professional private duty nurses and practical nurses which supported and operated a nurses' registry primarily to afford greater employment opportunities for its members was not entitled to exemption under section 501(c)(3) of the Code. Although the public received some benefit from the organization's activities, the primary benefit of these activities was to the organization's members.

According to Revenue Ruling 85-1, an activity is a burden of government if there is an objective manifestation by a governmental unit that it considers the activities of the organization to be its burden. Whether an objective manifestation exists may be shown by a variety of factors. Such factors include the following:

1) Whether an organization is formed pursuant to a state statute. The statute clearly defines the organization's structure and purposes.
2) Interrelationship with a governmental unit – the stronger the control a government has over the organization's activities, the more an objective manifestation exists.
3) A governmental unit previously conducted the organization's activity.
4) Payment of governmental expenses if the organization defrays the general or specific expenses of a local government or pays part of the government's debt is evidence of a governmental burden.
5) Sources of funding – if an organization regularly receives funding from the government in the form of general grants, as opposed to fees for services, there is indication that the government considers the activity to be its burden.
6) Whether an activity is one that could be performed directly by a governmental unit.

Revenue Ruling 85-2 provides that the activities of the organization, rather than its purpose, must be examined to determine whether the organization actually lessens the burdens of government. Also "The fact that an organization is engaged in an activity that is sometimes undertaken by the government is insufficient to establish a burden of government. Similarly, the fact that the government or an official of the government expresses approval of an organization and its activities is also not sufficient to establish that the organization is lessening the burdens of government."

APPLICATION OF LAW:

Section 501(c)(3) of the Code sets forth two main tests for qualification for tax exempt status. An organization must be both organized and operated exclusively for purposes described in section 501(c)(3).

Your purposes as provided in your Articles of Incorporation are board and vague. You state that your purpose is to serve as a resource center for compliance materials and services for the agribusiness industry. Your purpose of providing services to the agribusiness industry is not an inherently charitable activity and is often achieved in a commercial manner. Therefore, we can not conclude that you are organized exclusively for exempt purposes as provided in section 1.501(c)(3)-1(b)(1)(iii) of the regulations.

To satisfy the operational test, you must be operated exclusively for one or more exempt purposes as provided in section 1.501(c)(3)-1(b)(iii) of the regulations.

We hold that you not satisfy the operational requirements to be recognized as exempt under section 501(c)(3) of the Code. In fact, the administrative record demonstrates that you will operate for the substantial non-exempt purpose of operating a commercial business. In addition, you have not established that your income will not inure to the benefit of your three key Board members and owners of your predecessor for-profit organization. Furthermore, your revenue sharing contracts give rise to impermissible private benefits to the national and state associations, which are not recognized under section 501(c)(3) of the Code.

Evidence that you are operated in the manner of a commercial business is reflected in the fact that your operations have not changed as a result of your conversion to a non-profit entity. You still retain the same employees, provide the same services and continue charging the same level of fees as you did when you operated as a for-profit consulting firm. Your revenue will come exclusively from fees received from the sale of compliance consulting services you provide to for-profit businesses in the agricultural industry.

You are remarkably like the organization described in Airlie Foundation v. Commissioner, supra. You are operated for a non-exempt commercial purpose rather than for a tax-exempt purpose. As shown in the article published in P, your compliance consulting services directly compete with other compliance service businesses. One of the factors considered in assessing commerciality was the extent and degree of below cost services provided. You have provided no evidence that your clients receive free services, or services according to their ability or pay. You have not provided any evidence that your fees will bear any relation to the costs of providing your services and are not purely a profit-making tool. In addition, your clients are not limited to a charitable class of individuals. In fact, your clients are primarily for-profit businesses in the agricultural industry. Moreover, the language used in your advertising efforts, including your brochures clearly demonstrates that you will aggressively market your services to businesses in the agricultural industry in the manner of an ordinary for-profit business. Furthermore, your revenue sharing contracts with

the national and state associations are executed in order for these associations to promote your compliance consulting services among its membership and expand your client base. Thus, because of the commercial manner in which your activities are conducted, you are operated for a non-exempt commercial purpose.

You are similar to the organization described in B.S.W. Group, Inc. v. Commissioner, supra. Your activities constitute the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Your primary purpose is not charitable or education, but rather commercial. You have not shown that you will receive any support from contributions from the general public, government or private foundation grants, or public contributions. In fact, you have no fundraising program to solicit such contributions. By comparison, for-profit business enterprises are supported by fees paid by those who receive services. Like a for-profit business, all of your revenues are from fees paid by those who receive compliance consulting services from you. While charitable institutions often do provide services to individuals, the cost is generally subsidized by contributors who do not receive anything in return. Your fees however, are set high enough to recoup all projected costs and to produce a profit. Your fees have not changed since your conversion from a for-profit to a non-profit entity. Finally, you also do not limit your clientele to organizations that are exemption under section 501(c)(3) of the Code.

You have not provided any information to indicate that you plan to dedicate significant revenue to activities involving educational and/or charitable programs. In having a paid staff with no volunteer help, and having no direct expenditures for charitable and educational purposes, you are similar to the organization described in Easter House v. United States, supra, where the court determined that the organization was not exempt because its conduct of adoption services activity was in furtherance of a non-exempt commercial purpose. Similar to adoption services, your provision of compliance consulting services do not in and of themselves constitute an exempt purpose. The termination provision in your contracts makes it difficult for national and state associations to cease its revenue sharing arrangement with you in a way that is more typical of a trade or business. You do not operate a substantive public education program. Your educational materials are available on a retainer service basis. Even the compliance materials provided through your website is available only as part of your retainer services. Your Board of Directors, rather than being representative of a broad cross section of the community, is effectively controlled by individuals with a vested interest in you. Your Board consists of the three owners of your predecessor organization and representatives of the national or state associations or client representatives of yours. Your Board is not representative of the public interest. Thus, the totality of the facts and circumstances, show that you will be operated for the substantial non-exempt business purpose of selling compliance consulting services for retainer fees to agricultural businesses.

Like Better Business Bureau of Washington D.C., Inc. v. United States, supra, you have an "underlying commercial motive" that distinguishes your educational program from that carried out by a university.

In addition, you have not establish that your income will not inure to the benefit of your three key Board members who were also owners of your predecessor entity in accordance with section

1.501(c)(3)-1(d)(1)(ii) of the regulations and section 501(c)(3) of the Code. Your motivation to convert to a non-profit entity appears to be primarily profit driven. It appears that your predecessor for-profit business had reached its maximum growth potential. And the business owners of your predecessor organization and your current three key Board members recognized that there was an increasing risk of possible non-payers having access to their proprietary software. Thus, continuing as a for-profit entity was no longer viable as they were losing their ability to control and protect the technologies they had developed. Your current manner of operations and employees are identical to that of your predecessor with the exception that you now have entered into revenue sharing contracts with national and state association. Your revenue sharing contracts with the national and state enables you to widely expand your client base and increase your level of business, without fear of losing control over your proprietary resources. By having the national and state associations promoting your compliance consulting packages, you now have the potential to expand your consulting services to possibly every agricultural business in the nation.

Similar to Revenue Ruling 61-170, your primary purpose appears to be providing employment opportunities for your three key Board members and predecessor owners. The owners of your predecessor organization are now the three highest paid directors/officers of your organization. It is also unclear, given the fact that your employees are identical to of your predecessor, why compensation to directors/officers increased significantly following the conversion to a non-profit entity. Therefore, like Birmingham Business College, Inc. v. Commissioner, supra, you have not shown that your earnings do not inure to the benefit of your Board members, particularly the three key Board members who were the owners of your predecessor organization.

Like Church of Scientology of California v. C.I.R., supra, inurement results to the benefit of your three key Board members who own O, a for-profit title holding company. The three owners of O are personally enriched when you pay the expenses for modifying and updating the copyrighted intellectual properties, proprietary software and technologies including the 30 professionally produced videos, created prior to the date of conversion. These materials are owned by O but are now marketed or sold as part of your retainer service contracts.

Similar to Texas Trade School v. Commissioner, supra, inurement also results to owners of O due to the fact that any capital improvements made by you to the property you lease from O will become the property of O. The permanent increase in the value from any improvement you make on the property constitutes inurement to your three key Board members who also are the owners of O.

Furthermore, your revenue sharing contracts give rise to impermissible private benefits to the national and state associations, which are not entities recognized under section 501(c)(3) of the Code. Like International Postgraduate Medical Foundation v. Commissioner, supra, the state and national association are substantially benefiting from the revenue sharing contracts with you. The state associations are receiving from 21% to 37% of the retainer fees per client. These benefits to the national and state associations are substantial and constitute impermissible private benefits under section 501(c)(3) of the Code and section1.501(c)(3)-1(d)(1)(ii) of the regulations . Therefore, we hold that you are not operated exclusively for exempt purposes under section 501(c)(3) of the Code.

ORGANIZATION'S POSITION:

On Page 2 of your Date 4 correspondence, you indicated in support of your position that:

> **By helping agricultural businesses comply with the myriad of OSHA, EPA and DOT regulatory requirements, the instant taxpayer clearly provides a public benefit and lessens the burden of governmental agencies charted with overseeing and enforcing compliance. In view of the foregoing, it would appear undeniable that the taxpayer is advancing the charitable purpose for which was formed and for which it is obligated to advance by its articles of incorporation.**

In the attachment to Item 22 of your Date 3 response, you stated "...All of the regulatory requirements were promulgated to protect either the public or the farm center's employees. In all [you are] equipped to help farm center's address over 75 regulatory requirements." In the same attachment, you listed various examples of how the general public benefits if retail farm centers comply with various governmental regulatory requirements. Such benefits include identifying vulnerabilities to potential terrorist activities, preventing uncontrolled release of harmful chemicals which could be harmful not only to the public but the ozone, disclosing facilities' stored hazardous materials to the public, providing safer road travel, etc.

To further defend your position, you cited the following:

Revenue Ruling 81-278 (should be Revenue Ruling 81-276), 1981-2 CB 128 – it describes an organization that was established to perform the services of a professional standards review organization (PSRO). **The organization was formed pursuant to section 249F of the Social Security Amendments of 1972 and designated as a PSRO for a particular area by the Department of Health and Human Services.** Its primary activity was to review the professional activities of physicians and other health care practitioners as well as institutional and non-institutional providers of health care services. The organization developed and applied professional norms of care, diagnosis, and treatment, and determined whether services were medically necessary, the quality of services met professional standards, and when proposed services were to be on an inpatient basis, if the services could have been effectively provided on an outpatient basis or more economically provided at a different inpatient care facility. Generally, payments for medical services or items cannot be made under Medicare or Medicaid unless they are reviewed and approved by the organization. Membership into the organization is open without charge to all licensed practicing physicians in the organization's area. **All of the organization's income came from contracts with the Department of Health and Human Services**. This organization qualified for exemption under Internal Revenue Code section 501(c)(3).

Virginia Professional Standards Review Foundation v. Blumenthal, 466 F. Supp. 1164 (DC 1179) – the specifics in this case is similar to activities described in the previous revenue ruling. This organization's purpose was to assume the responsibilities and duties of a support center for PSROs.

The support center was "authorized by guidelines promulgated under the auspices of the Secretary of the United States Department of Health, Education, and Welfare or to perform similar functions." This organization had contracts with the Department of Health, Education, and Welfare and was responsible for carrying out affirmative education programs for physicians and assisted physician groups to form PSROs. **All of the organization's financial support came from income from contracts with the Department of Health, Education, and Welfare.** The Court determined that the organization was exempt as a charitable organization.

Revenue Ruling 70-79, 1970-1 CB 127 – this revenue ruling described an organization that assisted local governments of a metropolitan area that conducted research to develop solutions for common regional problems qualified for Internal Revenue Code section 501(c)(3) exemption as a charitable organization because it lessened the burdens of government. The organization's membership consisted of chief elected officers of several local jurisdictions. **This organization received financial support from federal grants, membership dues, and assessments from the local jurisdictions.**

Revenue Ruling 76-455, 1976-2 CB 150 – this revenue ruling describes an organization that was formed to encourage and assist in the establishment of nonprofit regional health data systems, conduct studies and propose improvements relating to the quality, utilization, and effectiveness of health care and health care agencies, and to educate those involved in furnishing, administering, and financing health care. The organization's membership consisted of active and associate members. Their active members were nonprofit operators of a regional health data collection program, which cooperated with health care agencies in a geographically identifiable area and regularly disseminated regional health data for that area. Associate members were hospital associations, medical associations, medical record associations, health insurance associations, etc. **This organization's financial support came from membership dues and grants from other organizations and governmental agencies.** This organization was determined to be exemption under section 501(c)(3) of the Code.

The previous revenue ruling was compared to Revenue Ruling 74-553, 1974-2 CB 168. In this revenue ruling, it held that an organization formed by members of a state medical association that operated peer review boards and conducted other related research and oversight functions for the primary purpose of establishing and maintaining standards for quality, quantity and reasonableness of medical service costs qualified for exemption under Internal Revenue Code section 501(c)(6) rather than section 501(c)(3).

On Page 2 of your Date 4 correspondence, you indicated:

> **We respectfully disagree with your analysis of the effect of Revenue Rulings 85-1 and 85-2 on the instant application. The list of factors referred to in your letter is not all-inclusive. The ruling do refer to the need for a determination that the involved governmental agency consider whether the organization's activities involve part of the governmental agency's burden and whether the organization's activities lessen the**

burden of the subject governmental agency. We respectfully submit that both tests are satisfied in this case. Thus, compliance with the governmental regulations is clearly an objective manifestation that the governmental agencies mentioned previously view compliance with their rules and regulations to be their burden. Otherwise, there would be no need for those agencies to promulgate their rules and regulations. It is also clear that those governmental agencies have a duty to oversee and enforce with the threat of sanctions those businesses failing to comply.

SERVICE'S RESPONSE TO ORGANIZATION'S POSITION:

You do not lessen the burdens of government. Unlike the organizations described in the revenue rulings and court case in the previous section, your income is not from governmental or public sources. Your sole source of financial support is come from fees for services rendered to businesses in the agricultural industry. Unlike the organizations described in Revenue Ruling 81-276 and the court case, Virginia Professional Standards Review Foundation v. Blumenthal, supra, you do provide services on behalf of a governmental agency. You were also not created by Congress or established by a governmental agency to oversee the professional standards of a particular industry. Instead, you are a successor to a for-profit consulting business that operated in an identical manner to you. In fact, you have not established that you share any collaborative relationship with the EPA, OSHA or DOT.

In Section IV of Virginia Professional Standards Review Foundation v. Blumenthal, supra, it stated: "To the extent that such an intent may be presumed to exist, it must be attributed to the **Congress which established the PSRO program**, in part at least, to spare the government the difficulties and expense occasioned by government overview, a task better suited for physicians themselves."

You have not provided evidence to show that your activities are an objective manifestation of government. You do not meet a majority of the factors listed in Revenue Rulings 85-1 to demonstrate that you are lessening the burdens of government including:

- You are not formed pursuant to a state statue.
- Governmental agencies do not have any level of control over the internal operations of your organization.
- A governmental unit has never conducted your organization's activity.
- You do not pay expenses related to activities of a governmental agency.
- You do not receive any form of funding from governmental grants, and all of your income is from fees for services.
- You are not engaged in an activity that could be performed by a governmental unit.

You are not lessening the burdens of government. The fact that there is no interrelationship between you and a governmental function is a strong indication that governmental agencies do not consider your activity to be its burden. In addition, you do not actually lessen the burdens of government as provided in Revenue Ruling 85-2. The role of the governmental agencies such as

EPA, OSHA and DOT is one of enforcement. It is the obligation and burden of the individual businesses to comply with the established regulatory requirements. In so far as you assist these for-profit retailers for a fee to come into compliance with the law, you are helping your clients to meet their obligations. Your objective appears to be the protection of agricultural retail businesses from enforcement actions by regulatory agencies. Since your viability is dependent on the services you provide to your clients, your ultimate aim is the protection of the business interests of your clients. This is the exact opposite function of the regulatory agencies which is formed to protect the public interest and to ensure compliance for the benefit of the community as a whole. Thus, your activities are directed at decreasing the farm centers' burden in complying with numerous and complex regulatory requirements imposed by various governmental agencies rather than enforcing the established regulatory requirements. Furthermore, your clients (individual businesses in the agricultural industry) benefit more than incidentally from your activities in direct contravention of section 1.501(c)(3)-(1(d)(1)(ii) of the regulations. The private interests served by your activities outweigh the public interests served. Therefore, exemption on the basis of lessening the burdens of government is inappropriate.

During a telephone discussion with you on Date 5, it was noted that the your activities are similar to those performed by certified public accounts (CPAs) and tax attorneys in that the tax professionals exist to help their clients understand and comply with the complex Internal Revenue Code. Also, during the telephone discussion on Date 5, you inquired if granting the organization exemption under section 501(c)(6) was an option.

Internal Revenue Code section 501(c)(6) is defined as "Business leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual."

Regulations section 1.501(c)(6)-1 states:

> **A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons. An organization whose purpose is to engage in a regular business of a kind ordinarily carried on for profit, even though the business is conducted on a cooperative basis or produces only sufficient income to be self sustaining, is not a business league...**

Exemption under Internal Revenue Code 501(c)(6) was considered but quickly dismissed for the following reasons:

1. Your primary activity is to perform services for your members/clients. Your services are aimed at assisting the members comply with regulatory requirements rather than promote a common business interest or improve business conditions as a whole.
2. Unlike most business leagues, your sole support of financial support will be derived from gross receipts for services rendered and/or merchandise sold. For business leagues, their primary sources of revenue come from membership dues and assessments.
3. You are operated in the manner of a for-profit trade or business and is therefore, not a business league as described under section 501(c)(6) of the Code.

CONCLUSION:

Based on the information you presented, you do not qualify for exemption under Internal Revenue Code section 501(c)(3) as a charitable or educational organization or under any other section within the Internal Revenue Code. You are operated for a substantial non-exempt purpose of operating a commercial business. You have not shown that your earnings do not inure to the benefit of your three key Board members who were the owners of your predecessor for-profit business. Your revenue sharing contracts give rise to impermissible benefits to the national and state associations which are not entities recognized as exempt under section 501(c)(3) of the Code. You do not lessen the burdens of government as you do not share an interrelationship with any of the regulatory agencies which would demonstrate that your activity is a burden of government. Additionally, you seek to protect your clients (businesses in the agricultural industry) from enforcement actions by the regulatory agencies, which is an activity that serves the private interests of your clients more than incidentally.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, Exempt Organization Appeal Procedures for Unagreed Issues.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". These items include:

1. The organization's name, address, and employer identification number;
2. A statement that the organization wants to appeal the determination;
3. The date and symbols on the determination letter;
4. A statement of facts supporting the organization's position in any contested factual issue;
5. A statement outlining the law or other authority the organization is relying on; and
6. A statement as to whether a hearing is desired.

The statement of facts (item 4) must be declared true under penalties of perjury. This may be done by adding to the appeal the following signed declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, Power of Attorney and Declaration of Representative, if you have not already done so. You can find more information about representation in Publication 947, Practice Before the IRS and Power of Attorney. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications. If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters. Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:
Internal Revenue Service
EO Determinations Quality Assurance
Room
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:
Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations
Rulings & Agreements

Enclosure:
Publication 892

200806021

Internal Revenue Service
Appeals Division
55 N. Robinson, Suite 939
MS 8000
Oklahoma City, OK 73102-9231

CERTIFIED

Department of the Treasury

Release Date: 2/8/08
Date: 11/8/07

A

B

UIL Code: 501.03-00

Taxpayer Identification Number:
C
Person to Contact:

Employee ID Number:
Tel:
Fax:
Refer Reply to:
AP:
In Re:
Exempt status
Tax Years:

Last Day to File a Petition with the
United States Tax Court:

Dear

This is a final adverse determination as to your application for exempt status under section 501(a) as an organization described under section 501(c)(3) of the Internal Revenue Code. Our adverse determination was made for the following reason(s):

You are not organized or operated for an exclusive exempt purpose as required by Internal Revenue Code section 501(c)(3).

You did not meet the organizational or operational tests as required by section 1.501(c)(3)-1(b) and 1.501(c)(3)-1(c)(1) of the Treasury Regulations. You have not established that your income will not inure to the benefit of individuals and shareholders, which is prohibited by Internal Revenue Code section 501(c)(3). You are operated for a substantial private purpose, which is prohibited by Internal Revenue Code section 501(c)(3).

Contributions to your organization are not deductible under Code § 170. You are required to file federal Form 1120 for the year(s) shown above.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed before the 91st (ninety-first) day after the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

You also have the right to contact the Office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778, and ask for Taxpayer Advocate assistance.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals procedures, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, or extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate, can however, see that a tax matter, that may not have been resolved through normal channels, gets prompt and proper handling.

We will notify the appropriate State officials of this final adverse determination of your exempt status, as required by Code section 6104(c).

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Charles F. Fisher
Appeals Team Manager

cc: